

***United States Court of Appeals
for the Second Circuit***



APPELLEE'S BRIEF

77-5003

To be argued by
MYRON TREPPER

In The
United States Court of Appeals
For The Second Circuit

In re:

THE FABRIC TREE, INC.,

Debtor.

MANGEL STORES CORPORATION,

Appellant,

vs.

THE FABRIC TREE, INC.,

Appellee.

*On Appeal from the United States District Court for the
Southern District of New York.*

BRIEF FOR APPELLEE

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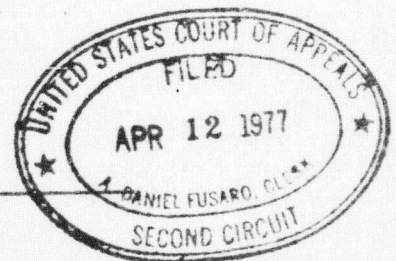


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Docket No. 77-5003

IN RE
THE FABRIC TREE, INC.,
Debtor-Appellee.

MANGEL STORES CORPORATION,
Appellant.

On Appeal from the United States District Court
For the Southern District of New York

BRIEF OF
THE FABRIC TREE, INC.

ISSUES PRESENTED

1. Whether the Bankruptcy Court had jurisdiction over appellant so as to enable it to adjudicate the rights of appellant, appellee, the Fabric Tree, Inc. and its creditors, as to matters attendant to the deposit of consideration necessary to confirm the debtor-appellee's Plan.

2. Whether the Bankruptcy Court's determination that appellant was obliged to fulfill its commitment to fund appellee's Plan and the order of August 2, 1976, which is the subject of this appeal, must be affirmed on the grounds that they are not clearly erroneous and, in fact, constitute a proper exercise by the Bankruptcy Court of its discretion and powers.

3. Whether the conduct of the proceedings in the Bankruptcy Court afforded appellant optimum due process and were, in fact, consented to by appellant throughout their course.

STATEMENT OF THE CASE

Appellant brings before this Court an appeal from an order entered on July 11, 1977, by the Honorable Henry F. Werker, which affirmed an order entered August 2, 1976, confirming appellee's Chapter XI proceeding. The aforesaid

Order of Confirmation was entered by the Honorable Roy Babitt, Bankruptcy Judge acting on behalf of his colleague, the Honorable Stanley T. Lesser, Bankruptcy Judge, who had been in charge of and supervised the administration of the Chapter XI proceedings of appellee before the Bankruptcy Court.

The Order of Confirmation was entered based upon findings of Judge Lesser that appellant was required to fund appellee's arrangement employing a fund of \$600,000, which had been deposited with the Chairman of the Official Creditors' Committee elected in the Chapter XI proceedings. Said fund of \$600,000 had been deposited pursuant to a series of agreements executed on May 4, 1976. There were three agreements which were executed on that date, all of which are inextricably interrelated and designed to implement and achieve a single purpose, to wit, the acquisition by appellant of ownership and control of the business of appellee. That acquisition could only have been accomplished by appellant's making available sufficient funds to enable appellee to confirm a Plan in the Chapter XI proceedings.

Appellant has argued both before Judge Lesser and on review before Judge Werker, that it should not have been required to deposit the consideration necessary to fund appellee's Plan, contending that certain conditions precedent

to its obligation had not been met. After a full evidentiary hearing Judge Lesser, in his decision dictated into the record on July 30, 1976, found that all of the conditions of appellant's commitment, save one, had been complied with, and that the one condition which had not been strictly adhered to, i.e., confirmation of the debtor's Plan by July 15, 1976, was not a condition which, in light of the facts and circumstances, required strict enforcement.

Judge Werker has carefully reviewed the findings of Judge Lesser and has, in essence, adopted them without modification or alteration, finding that in his judgment, the Bankruptcy Court's findings and conclusions were not clearly erroneous and, in fact, constituted a proper exercise of the Bankruptcy Court's jurisdiction, discretion and powers.

Appellee firmly believes that the findings and conclusions of Judge Lesser and of Judge Werker are amply supported by both the record and by applicable principles of Bankruptcy Law.

THE FACTS

The Fabric Tree, Inc. ("Fabric Tree") was engaged in the business of selling yard goods, notions and related items through some thirty retail outlets located in shopping centers in several states in the eastern United States. Fabric Tree filed a petition under Chapter XI of the Bankruptcy Act

in August of 1975, for the purpose of restructuring its operations and ridding itself of unprofitable store locations so as to enable it to formulate and implement a plan with its creditors.

In April of 1976, appellant, Mangel Stores Corporation ("Mangels") commenced negotiations with Fabric Tree through its principal officers who owned all of the issued and outstanding stock of the company, the design and purpose of said negotiations being an acquisition by Mangels of the stock of Fabric Tree. If Mangels were able to acquire the stock of the Fabric Tree, it would, in essence, be acquiring all of the locations operated by the Fabric Tree and its wholly owned subsidiaries, each of which had been formed for the express purpose of operating store locations in various shopping centers. It was Mangels' design and purpose through such a transaction to acquire an existing thirty store chain of locations which it could then convert to operations consistent with Mangels' form of business, that being the operation of retail stores selling ladies' apparel and related items. (A. pp. 111-113)

Negotiations regarding the manner and mode of acquisition continued for a period of approximately two weeks and resulted in the execution on May 4, 1976, of three agreements which can be described as follows:

- A. A Purchase and Sale Agreement between Mangels and the principals of Fabric Tree, wherein Mangels agreed to acquire the stock of the principal shareholders for the purchase price described therein and on terms and conditions fully set forth in the agreement, with the proviso that Mangels' commitment to purchase was dependent upon confirmation of a plan in the Chapter XI proceedings of Fabric Tree. (A. p. 216)
- B. A Loan and Security Agreement (A. p. 243), wherein and whereby Mangels agreed to lend to Fabric Tree the sum of \$338,369.86*. The agreement further contemplated that Mangels would, pending confirmation of a plan by Fabric Tree, make additional advances to Fabric Tree under the Loan and Security Agreement so as to provide a flow of merchandise to Fabric Tree locations so that the business

*The sum of \$338,360.86 was immediately necessary to repay an entity which had, at the time that Mangels began negotiations with Fabric Tree, already agreed to fund a plan with creditors and to supply Fabric Tree with merchandise on credit so as to keep Fabric Tree stores relatively well stocked with inventory items. In order for Mangels to replace this third party acquirer and to thereby acquire Fabric Tree, the existing third party had to be paid for all merchandise which it had delivered on credit.

of Fabric Tree could continue in its ordinary course. As collateral for all advances to be made by Mangels it was to be granted a security interest in all of Fabric Tree's assets of any nature whatsoever.

- C. An agreement between Mangels and the Official Creditors' Committee of Fabric Tree (A. p. 240) (hereinafter sometimes referred to as "the commitment"), under which Mangels deposited \$600,000 with the Chairman of the Committee and agreed that that sum would be used to fund a plan described in the Agreement upon certain express terms and conditions stated therein.

On May 4, 1976, the Purchase and Sale Agreement and the Loan and Security Agreement were executed and the commitment was delivered to the Chairman of the Committee, together with a Certificate of Deposit duly endorsed to the order of the chairman in the face amount of \$600,000. The commitment contained certain conditions. First, it required that a 15% all cash plan for creditors in the Chapter XI proceedings be confirmed by July 15, 1976, and that the amounts necessary to confirm said plan should not exceed \$450,000 for the payment of unsecured claims and \$150,000 for all priority and administration expenses. Second, it was necessary that an order be

entered no later than May 10, 1976, by the Bankruptcy Court granting to Mangels a first and continuing security interest in all assets of the Fabric Tree of any nature whatsoever wherever located. Such an order was, in fact, obtained prior to May 10, 1976, and a plan consistent with the commitment was filed with the court shortly thereafter. There followed a series of events designed to implement and effectuate the terms and conditions of all of the agreements and to achieve the ultimate goal of all parties, confirmation of the Plan.

The Official Creditors' Committee immediately solicited from the general creditor body consents to the Plan and within a relatively short period of time was able to accumulate the necessary majorities in number and dollar amount of creditors so as to enable the Bankruptcy Court to enter an order finding that the Plan as promulgated by the Fabric Tree had been accepted.

During the course of the solicitation process the business operations of Fabric Tree continued and were closely supervised and monitored by Mangels since Mangels had already made a significant pecuniary investment in Fabric Tree's business by virtue of the advances made under the Loan and Security Agreement previously adverted to.

Upon the entry of the Court's Order Finding the Plan accepted, Fabric Tree began to move assiduously towards con-

firmation of the Plan and attempted to adjust without necessity of litigation, certain claims which had been filed for amounts in excess of that which the books and records of the company indicated to be due and owing to certain creditors. During the course of this process there were various hearings before the Bankruptcy Court wherein progress reports were made to the Court, and at all or substantially all of such hearings representatives of Mangels were present so that they could keep themselves fully apprised of the events occurring at each stage of the confirmation process.

As Judge Lesser's decision indicates, Mangels, at some time in mid or late June of 1976, apparently became disenchanted with its intended acquisition of Fabric Tree (A. p. 279) and a series of events then transpired which led to a total disintegration of the relationship between Fabric Tree and Mangels, all of which precipitated the activities thereafter occurring before the Bankruptcy Court, which resulted in the decision of Judge Lesser dated July 30, 1976, affirmed by Judge Werker by order dated January 11, 1977, which order is now on appeal to this Court.

On July 15, 1976, Fabric Tree, through its counsel, advised the Court that it was not in a position to submit an Order of Confirmation because the debtor had apparently been

unable to reduce general unsecured claims to such an amount as would necessitate a deposit of no more than \$450,000 to pay 15% of them. In addition, administration and priority expenses exceeded \$150,000 as at July 15, 1976. However, there were certain disputes between Fabric Tree and Mangels as to what expenses could properly be classified within that \$150,000 limitation so that the question of whether the \$150,000 requirement could be met was not clearly determined. Certain off the record conferences both between the parties and between the parties and the Court thereafter transpired and it became apparent that there were significant disputes between both Fabric Tree and Mangels as to the nature and extent of the Mangels commitment. It was agreed that business operations would continue under the supervision of the Court at least through July 27, 1976, when the parties would once again appear before Judge Lesser to advise him as to whether any progress had been made in resolving the disputes between the parties, which at the very least would permit Fabric Tree to continue in business and to perhaps confirm its own Plan or find new third party financing if, in fact, Mangels was not bound to its commitment.

Between July 15 and July 27, 1976, representatives of the Official Creditors' Committee of Fabric Tree became embroiled in the controversy and steps were taken by Fabric Tree and

unsecured and administration creditors, which had the effect of enabling Fabric Tree to advise the Court on July 27, 1976 that it was in a position to submit an Order of Confirmation which would fall within the \$600,000 limitation of the Mangels commitment. Certain allegations were made in colloquy before Judge Lesser regarding activities of Mangels, which, in essence, had prevented compliance with the July 15, 1976 condition and after oral argument Judge Lesser determined that it was necessary to hold a full evidentiary hearing. With the consent and acquiescence of all parties, including Mangels, such a hearing was held in the afternoon of July 27, 1976, concluding in the evening of that day.

Judge Lesser took the matter under advisement on July 27, 1976, and rendered a decision on July 30, 1976. He concluded that the Court had jurisdiction over the controversy and found that the conditions of Mangels' commitment had been met in all respects except for the occurrence of confirmation on July 15, 1976, and that based upon the testimony adduced at the evidentiary hearing it was his conclusion that the July 15, 1976 date had no business significance and should not be strictly enforced. Consistent with Judge Lesser's findings and his decision an Order of Confirmation was entered on August 2, 1976, and the \$600,000 Certificate of Deposit is

now held by the Court appointed Disbursing Agent pending the determination of the instant appeal.

During the course of the appellate process Mangels applied to Judge Lesser for leave to foreclose upon the collateral granted it under the Loan and Security Agreement and that relief has been granted to Mangels. The result is that all business operations of Fabric Tree have ceased, its assets have been liquidated, leaving no equity therein for Fabric Tree's general unsecured creditors and therefore the only fund now available to satisfy the claims of creditors of Fabric Tree is the \$600,000 deposited for confirmation of the arrangement.

FABRIC TREE'S POSITION

It is Fabric Tree's contention that the Bankruptcy Court had jurisdiction over the controversy between the parties which has resulted in the instant appeal and that the findings of Judge Lesser are not clearly erroneous and constitute a proper exercise of his powers and discretion as a Court charged with the responsibility of supervising, and where possible, implementing and effectuating the rehabilitative purposes of Chapter XI and the process of confirmation which is an integral part thereof. Fabric Tree firmly believes that both the decision of Judge Lesser and the order of Judge Werker

affirming Judge Lesser's decision and adopting his findings, are bottomed on sound legal, equitable, and factual bases.

Mangels' arguments that it has been denied due process and an adequate opportunity to be heard find no support in, and in fact are contradicted by the record, which indicates that Mangels consented to participate in the proceedings reserving only its right to contest the jurisdiction of the Bankruptcy Court to determine the controversy.

It must be borne in mind that more is at stake in these proceedings than Mangels' alleged right to return of its \$600,000 deposit. Mangels has, in effect, had the benefit of its bargain, since the foreclosure by it upon its collateral vested Mangels with ownership and control of Fabric Tree and its assets, leaving Mangels free to do with those assets whatever it deems to be necessary and appropriate. Mangels thereafter saw fit to sell those assets and that sale has been consummated, the proceeds being held pending the determination of this appeal. Fabric Tree and its creditors are left at the present time with nothing but the \$600,000 deposit which was part and parcel of the bargain made between the parties and which was, in essence, the purchase price which Mangels agreed to pay for the privilege of acquiring the assets of Fabric Tree which it has since sold. To return to Mangels the \$600,000 which has previously been deposited

would leave Fabric Tree and its creditors with nothing and would place Mangels in the position of having the best of both worlds. Mangels may not be pleased with the results of its acquisition, however, that acquisition was the result of a commercial transaction between sophisticated businessmen, and in all such transactions the parties bear obvious business risks. Courts should not be intruded into these transactions in an effort to insulate parties from possible detrimental effects of the bargain upon either of them. Mangels may well regret its decision to acquire Fabric Tree but should not be permitted to employ the appellate process to negate the possible detrimental effects of an apparently ill conceived business decision.

ARGUMENT

POINT I

THE BANKRUPTCY COURT HAD JURISDICTION OVER APPELLANT SO AS TO ENABLE IT TO ADJUDICATE THE RIGHTS OF APPELLANT, APPELLEE, THE FABRIC TREE, INC. AND ITS CREDITORS, AS TO MATTERS ATTENDANT TO THE DEPOSIT OF ~~CONFIRMATION~~ NECESSARY TO CONFIRM THE ~~APPELLANT'S~~ APPELLEE'S PLAN.

Section 311 of the Bankruptcy Act confers on courts of bankruptcy exclusive jurisdiction of the debtor and his property, wherever located. That jurisdiction has been extended to grant to the Bankruptcy Court exclusive summary jurisdiction:

"To determine controversies with respect to property owned by the debtor or in the actual or constructive possession of the debtor or The Bankruptcy Court." Mithers v. Barasch, 439 F. 2d 1393, 1395 (9th Cir. 1971).

In citing with approval the holding in the Barasch case, the Circuit Court of Appeals for the 9th Circuit delineated the broad principles of Bankruptcy Court jurisdiction in In re Stockman Development Company, 447 F2d 897 (9th Cir. 1971), carefully noting the clear intention on the part of courts called upon to determine the extent of Bankruptcy Court jurisdiction to find a broader scope of jurisdiction in proceedings for arrangement under Chapter XI. The court in Stockman indicated that broader jurisdictional principles apply in arrangement proceedings since overall control over the assets and property of the debtor is often vital to the success of the rehabilitation process, as distinguished from the liquidation process in straight bankruptcy proceedings where more strictly confined areas of jurisdiction may reasonably be proscribed.

Judge Werker, in his holding below, cited Stockman

with approval and stated at page 7 thereof (A. n. 333):
"I am mindful that Chapter XI arrangements serve ameliorative purposes distinct from those of other bankruptcy proceedings and that they therefore justify a broad construction of the court's jurisdiction."

Mangels has contended that the Bankruptcy Court could not properly exercise jurisdiction over the deposit of consideration with the Chairman of the Official Creditors' Committee in the Chapter XI proceedings because an exercise of summary jurisdiction requires that that jurisdiction be exercised over property in the actual or constructive possession of the court or the debtor. Such contention gives no credence to recent holdings which have broadened the scope of Bankruptcy Court jurisdiction in instances where the courts were convinced that to refuse to take jurisdiction over a controversy would undermine the effectiveness of the Bankruptcy Courts as a vehicle for the resolution of serious economic problems.

In In re Fox Metal Industries, Inc. v. Frontier Heating & Plumbing Co., 453 F.2d 1128 (10th Cir. 1972), Fox, a sheet metal contractor, entered into an agreement with Frontier, wherein Fox was to perform services as a sub-contractor of Frontier. During the course of the

relationship between Fox and Frontier, Fox filed a petition under Chapter X of the Bankruptcy Act, and a receiver was appointed in those proceedings to collect accounts receivable of Fox and to investigate the possibility of a Chapter X reorganization.

During the course of its operations under Chapter X Fox's performance suffered and Frontier, through its officers, entered into agreements with the receiver regarding modifications of the terms of the pre-bankruptcy contract. Thereafter Frontier stopped payment on certain checks drawn to Fox, alleging that Fox had failed to perform certain obligations under the contract. The receiver sought recovery from Frontier of the funds represented by the dishonored checks in an adversary proceeding in the Chapter X Court and Frontier resisted the receiver's application alleging that the Bankruptcy Court was without jurisdiction to determine the controversy. The District Court determined that it had jurisdiction over the controversy and held an evidentiary hearing, and at the conclusion thereof, found for the receiver. Frontier appealed to the Court of Appeals for the 10th Circuit and that Court in affirming the District Court was impressed with the Trial Judge's analysis of the situation presented to him, wherein the Trial Judge recognized the difficulty in determining whether the dishonored checks were, in fact, property

to which the Court's jurisdiction would attach. The Appellate Court agreed with the Trial Judge's analysis that the issue of whether the checks in question were pieces of property and/or assignments of funds was irrelevant and agreed that the Trial Judge having all of the facts, circumstances and parties before him was the party best in position to look through the checks to determine what the actual relationship of the parties was. The Circuit Court adopts the reasoning of the Trial Judge where he states as follows:

"...I'm looking through the checks as to what actually the relationship of the parties was. And the thing that impresses me is.. that there was an imposition on the receiver and the property of the court as far as these people were concerned. They sought to become whole at the expense of the receivership and to let them get away with it, as I say, would give them property to which they are not equitably entitled." (id. p.1130)

A similar holding with regard to the ever broadening scope of bankruptcy jurisdiction can be found in Governor Clinton Corp. v. Knott, 120 F.2d, 149 (2d. Cir. 1941) where the courts of this Circuit approved a Bankruptcy Court's taking jurisdiction over a controversy although the actual res in question was not in the actual or constructive possession of the Court. In its affirming opinion the Court stated at page 152:

Summary jurisdiction may be invoked for purposes other than to protect property within

the actual or constructive possession of the court. Here a contract was made with the debtor in possession and a fraud worked upon this estate to a common conspiracy among the respondents. This amounts to a fraud and imposition upon the court itself; and in such cases the court undoubtedly has summary jurisdiction to protect itself and the interests of the persons and property within its custody."

In both the Fox and Governor Clinton cases cited herein obvious and compelling reasons to proceed by summary jurisdiction were presented and according to Judge Werker at page 6 of the decision below, (A. p. 332) the controversy in the case at bar merits similar treatment. As Judge Werker correctly observes, the argument of Mangels that only the granting of the security interest to it was a matter which required and was, in fact, granted court approval, does not remove from the Bankruptcy Court's jurisdiction determination of controversies arising out of inextricably interrelated companion agreements. As Judge Werker states:

"...The security agreement submitted to and approved by the bankruptcy court granted Mangel an interest in assets plainly within the custody of the court. But that agreement comprised only one element of a larger plan whereby Mangel would gain control of Fabric Tree and its assets. The extent to which the signing of each agreement hinged upon the successful negotiation of the others is best demonstrated by reference to the language of the security agreement presented to the court below for approval. It states that Mangel:

"... intends to provide funds to Fabric [Tree] to confirm a plan of arrangement

in the Proceedings and in connection therewith has contracted to purchase all of the outstanding common stock of Fabric [Tree]. ' ' (id. p. 332)

Judge Werker recognized, as did Judge Lesser, that by the time the relationship between the parties had disintegrated to the point of controversy with regard to the escrow provided for in the commitment, Mangels had become intimately involved in the operations of Fabric Tree and agreed with Judge Lesser that while Mangels had apparently never formally entered an appearance its "presence was here. We felt it. We saw it. We were told about it." (A. p. 288)

Judge Werker correctly concluded that it would work an unfair imposition upon the operations of the Bankruptcy Court were it not permitted to decide disagreements under the escrow agreement. (A. p. 333) Judge Werker also concluded in his opinion that a denial of summary jurisdiction in the case at bar would seriously impose upon efforts undertaken by the Bankruptcy Court at the behest of many parties including Mangels. (A. p. 335)

Judge Werker has, in upholding Judge Lesser's decision to take jurisdiction over the matter, agreed and Fabric Tree contends correctly so, that the holdings in the Fox Metal and Governor Clinton cases should control in this matter at least to the extent that they

conflict with holdings of other cases cited by Mangels which might in some manner circumscribe the scope of summary jurisdiction in Bankruptcy Courts.

Cases cited by Mangels which would appear to circumscribe jurisdiction, Bayview Estates, Inc. v. Bayview Estates Mobile Home-Owners Assoc., 508 F.2d 405 (6th Cir. 1974), and In re H.L. Gentry Construction Co., 200 F.Supp. 546 (E.D. Mich. 1961), aff'd, 314 F.2d 945 (6th Cir. 1962) are clearly distinguishable from the case at bar in that neither of them involved the creation of an escrow fund in any way related to matters pending before the Bankruptcy Court. Where such facts are presented it is appropriate to deny summary jurisdiction and relegate the parties to plenary action to determine controversies involving such an escrow. However, the case at bar presents facts which indicate that the escrow here involved was an absolute and integral part of an overall scheme which would enable Mangels to gain control over the assets and properties of an entity then under the exclusive summary jurisdiction of the Bankruptcy Court and, in fact, such acquisition and control could not have been accomplished absent an order of the Bankruptcy Court confirming Fabric Tree's Plan. All of the parties to

this controversy, Mangels, Fabric Tree and the Official Creditors' Committee and its chairman, were parties who looked to and required the sanction and approval of the Bankruptcy Court in order to obtain the benefits of a bargain. It would be a gross injustice to permit Mangels to extract a part of the agreement from the Bankruptcy Court's jurisdiction upon some highly technical argument that gives no consideration to all of the surrounding facts and circumstances affecting the transaction as a whole.

Judge Lesser correctly stated that the courts of bankruptcy are vested with the inherent control and supervision of the processes of confirmation, and as such their summary jurisdiction must be extended to determine controversies of the nature of the case at bar, the resolution of which go to the heart of the confirmation process. (A. pp. 283, 284)

POINT II

THE BANKRUPTCY COURT'S DETERMINATION THAT APPELLANT WAS OBLIGED TO FULFILL ITS COMMITMENT TO FUND APPELLEE'S PLAN AND THE ORDER OF AUGUST 2, 1976, WHICH IS THE SUBJECT OF THIS APPEAL, MUST BE AFFIRMED ON THE GROUNDS THAT THEY ARE NOT CLEARLY ERRONEOUS AND, IN FACT, CONSTITUTE A PROPER EXERCISE BY THE BANKRUPTCY COURT OF ITS DISCRETION AND POWERS.

Rule 810 of the Rules of Bankruptcy Procedure provides that the conclusions of a Bankruptcy Judge must stand

unless they are shown to be clearly erroneous. The order of Judge Werker which is on appeal to this Court, found, in fact, that the findings of Judge Lesser, which Judge Werker adopts and shares, were not clearly erroneous and are, in fact, amply supported by the record of the July 27, 1976 evidentiary hearing. Fabric Tree contends that both Judge Lesser and Judge Werker have made sound and correct judgments with respect to the findings they have made and nothing contained in either Judge Lesser's decision or in the decision of Judge Werker can be classified as clearly erroneous so as to require reversal or modification.

The record of the July 27, 1976 evidentiary hearing demonstrates in clear and convincing fashion that that portion of the Mangels commitment which required confirmation of a plan by July 15, 1976, was a condition which did not require enforcement in light of the facts and circumstances surrounding the relationship between the parties during the course of their dealings from May through July, 1976.

It was the clear and unequivocal purpose of Mangels to acquire the assets and properties of Fabric Tree so as to take unto itself an existing thirty store chain of locations suitable for conversion by it to operations consistent with Mangels' form of doing business. (A. pp. 111, 112, 113)

In the Purchase and Sale Agreement (A. p. 215) the shareholders were required to obtain from Fabric Tree's existing landlords, agreements which would enable conversion of store locations then operated by Fabric Tree to ladies' ready-to-wear type of operations. It is pertinent to note that such consents to conversion were not required to be obtained until six months after the entry of an order confirming the Plan (A. p. 222) so that no significance can be given to the July 15, 1976 date as it may have affected Mangels' ability to immediately operate its own type of business at Fabric Tree locations. Mangels indicated at all times that it was its intention to continue to operate a fabric business identical to that conducted by Fabric Tree pending an orderly change over to Mangels' type operations as consents to conversion were received. (A. pp. 109, 110, 180) Mangels was therefore aware that it would be required to support the Fabric Tree operation by providing through cash advances, purchases of inventory for its own account and guarantees to vendors, sufficient fabric related inventories to enable intelligent and profitable operations to continue within the Fabric Tree chain. (A. pp. 117, 142, 143, 144)

Fabric Tree provided Mangels with income projec-

tions indicating prospective sales volume and required inventory levels to meet those sales volumes, all indicating that profitable operations could not be reasonably expected prior to August 16, 1976, and in that connection it would be necessary to purchase inventories during the months of May, June and July of 1976 in order that the corner could be turned and profitable operations assured by the August 16, 1976 date. (A. pp. 119-121, 148, 149)

Since Mangels was possessed of sufficient financial data demonstrating that continued fabric operations would require inventory investments approximating \$1 million through and after July 15, 1976, it cannot be reasonably argued that the July 15, 1976 date had any real business significance. The uncontroverted testimony of the president of Fabric Tree was to the effect that the only significance of the July 15, 1976 date was that it was believed that the inclusion of such date would prompt and pressure the Official Creditors' Committee to quickly solicit and obtain the necessary acceptances to enable the debtor's Plan to be found to have been accepted by the Court. (A. pp. 123, 124) Such a condition is not unusual in third party acquisitions in Chapter XI proceedings, since it is reasonable to expect that a third party would desire to know in the shortest possible time whether creditors were

willing to accept the Plan which the third party had agreed to fund. The record also demonstrates that the acceptances were, in fact, received well before the July 15, 1976 date and Fabric Tree contends that insertion of the July 15, 1976 date had therefore accomplished the narrow purpose for which it was intended.

Reference to the record clearly indicates the reasonableness of Judge Lesser's findings with regard to many matters. Mangels, during the months of May and June, 1976, advanced or made available monies or inventories designed to enable Fabric Tree to meet the previously discussed business Plan and achieve a profitable position by the end of August, 1976; (A. pp. 120, 121, 124, 125, 149) but well prior to July 15, 1976, Mangels set about a course of action which made the achievement of profitable levels at the appointed date virtually impossible. By its own testimony Mangels established that it had issued instructions cancelling purchasing orders and terminating trade guaranties prior to July 15, 1976, thereby eliminating the requisite flow of merchandise to Fabric Tree which would enable it to achieve profitability within its projections. (A. pp. 124, 184, 185, 186) Mangels has argued that it halted the flow of merchandise to Fabric

Tree because of controversies relating to Fabric Tree's use of the proceeds of Mangels' collateral to pay expenses of the Chapter XI proceeding admittedly due and owing but incurred prior to May 4, 1976, the date at which Mangels first became involved in these proceedings by agreement. Mangels argues that it did not intend by its agreement to permit Fabric Tree to pay expenses of administration incurred before May 4, 1976. An examination of the Loan and Security Agreement indicates, however, that there was no prohibition or limitation with regard to such expenditures and that while Mangels had it within its power and control to at any time demand the turnover to it of the funds received representing proceeds of its collateral, thereby controlling expenditures, it did not do so until July 27, 1976. That demand was made during the course of colloquy before Judge Lesser; pursuant to written note delivered to counsel which did not comport with the notice provisions of the agreement. (A. pp. 28, 29)

Mangels' argument that pre-May 4, 1976 expenses could not properly be paid although admittedly all of those expenses were proper and valid administration li-

aties, taxes credibility and sound business judgment. It must be noted that Mangels, having recently emerged itself from a successful Chapter XI proceeding, could not reasonably protest ignorance of the provisions of Chapter XI and the requirement that all expenses of administration be paid in the ordinary course of business. All of the facts and circumstances elicited at the evidentiary hearing of July 27, 1976, indicate clearly that, as Judge Werker concluded, Mangel wrongfully prevented confirmation on July 15, 1976, and had, in fact, waived its rights to rely upon the clauses in the Loan and Security Agreement requiring immediate delivery to it of the proceeds of its collateral. (A. p. 337)

The record supports the conclusion, that by virtue of its secured position and status as an administration creditor, Mangels had effective control over the business of the debtor in possession and the fate of the company throughout the relationship between the parties and that confirmation, whenever it occurred, was a mere ceremony having no business significance. (A. pp. 201, 202, 204, 205)

Further, it is established that Mangels intended at all times to operate fabric stores pending determina-

tion as to which stores, if any, were to be converted to apparel stores, thereby making it clear that for business purposes Mangels had it within its sole control to determine whether the flow of merchandise would be adequate to meet the agreed upon projections as to profitability. (A. pp. 183, 184)

Obviously, the most important item sought by Mangels in this acquisition was the leases for various stores, control of which it obtained by the pledge to it of the stock of the debtor and its subsidiaries. (A. pp. 185-187) The July 15, 1976 deadline had no impact whatsoever upon such leases and, in fact, as at July 27, 1976, the record indicates that the leases were and remained in full force and effect with no change having occurred between July 15 and July 27, 1976. (A. p. 186) The physical assets of Fabric Tree at store level consisting of leasehold improvements, furniture and fixtures and inventories had not materially changed between July 15 and July 27, 1976. (A. p. 186)

It is important to note that it was not contemplated by the parties that confirmation of a plan would in any way improve Fabric Tree's credit position in the

commercial marketplace, and to the contrary, it was fully recognized that a continuing commitment from Mangels would be necessary after confirmation in the form of cash advances and/or trade guaranties so as to assure a constant flow of merchandise. (A. pp. 123, 126) It cannot therefore be reasonably argued that confirmation was an event which would in any way eliminate the requirement that Mangels continue to fund Fabric Tree operations on and after July 15, 1976, another factor which indicates the total lack of significance of the July 15, 1976 date.

The record amply demonstrates that there was no importance to the July 15, 1976 date save for its insertion as basically a pressure tactic designed to elicit an early response from creditors with regard to the Plan, which purpose it admirably served. Other than prompting the early receipt of acceptances the time condition was not of the essence and there is no express provision in the agreements between the parties to the effect that it is.

Recognized hornbooks and treatises which have construed and reviewed the effect of conditions contained in agreements and contracts come to a common conclusion with regard to such conditions. Such conclusion is clearly en-

nunciated in Williston on Contracts, §663, at 127 wherein it is stated as follows:

"Whether a provision in a contract is a condition the nonfulfillment of which excuses performance depends upon the intent of the parties, to be ascertained from a fair and reasonable construction of the language used in the light of all the surrounding circumstances when they executed the contract."

The treatise cites as authority for the foregoing, the case of Lach v. Cahill, 138 Conn. 418, 85 A2d 481, wherein the court stated that courts are disinclined to construe provisions in contracts as conditions precedent unless the nature and language of the contract compels them to do so and more importantly, where to so construe language in a contract as a condition precedent would result in injustice.

In the case of Leroy Dyal Co., Inc. v. Allen, 161 F 2d 152 (4th Cir. 1947), the Court of Appeals for the 4th Circuit reviewed a decision of a District Court which released a contracting party from all obligations under a contract when the facts and evidence adduced clearly indicated that said party was in no way injured by the departure of the other party to that contract from the precise terms thereof. In reversing the District Court, the Circuit Court enunciated certain equitable principles employed in construction of conditions in contracts which are pertinent in the case before this Court. The court stated at page 155:

"***it will be noted that the growing tendency has been to modify the harsh and often inequitable rule of the common law, and the courts now determine each case upon its own peculiar facts, the question as to whether time is of the essence of the contract being one of construction controlled by the intention of the parties, and the courts, in the absence of an express stipulation making time as of the essence, are not disposed to so treat it, unless that the parties intended that it should be ineffectual unless performed within the time stated."

The Court cites with approval the holding of the Appellate Term of the Supreme Court of New York County in the case of New Jersey Co. v. Nathaniel Wise Co., 55 Misc. 294, 105 N.Y.S. 231, when that Court was likewise called upon to construe contractual language with regard to conditions of time and in its decision upheld the contract although strict compliance with the terms thereof was not present. The Court stated at page 232:

"The rule that time is to be regarded as of the essence was originally designed to carry out the presumed intention of the parties. When it is clear that the application of this rule would be contrary to the intention of the parties, the reason for the application of the rule no longer exists, and the rule itself is inoperative. The adoption of a reasonable construction, which gives effect to the original intention of the parties, is more in harmony with the spirit and reason of the general rule than is adherence to a narrow and literal interpretation, which does not effectuate such intention."

As indicated in the record of July 27, 1976, there was no material change in the lease situation or assets or

business of the debtor in possession from and after July 15, 1976 and Mangels was always in a position to receive all that it bargained for in its agreements with Fabric Tree. Accordingly, delay in performance is immaterial and the condition of confirmation on or before July 15, 1976 should not be enforced. This is made clear by Restatement, Contracts, §276(a) at 406:

"In determining the materiality of delay in performance, the following rules are applicable:

- (a) Unless the nature of a contract is such as to make performance on the exact day agreed upon of vital importance, or the contract in terms provides that it shall be so, failure by a promisor to perform his promise on the day stated in the promise does not discharge the duty of the other party."

No distinction is made as to the application of this principle in law as opposed to equity. There being no fluctuation in the value of the assets in the case at bar or in Mangels being able to obtain what it bargained for, strict enforcement of a time condition is inappropriate. Cf. Farris v. Ferguson, 146 Tenn. 498, 242 S.W. 876, 23 A.L.R. 624.

While it cannot be reasonably argued that the July 15, 1976 date in the commitment should have been enforced,

response is required to Mangels' argument that Fabric Tree had failed to meet another condition of the commitment, to wit, the dollar requirements of confirmation. Mangels certainly would not have been required to go forward with its commitment on any date if the cash necessary to fund the Plan exceeded \$450,000 for general unsecured claims and \$150,000 for priority and administration expenses. The record before Judge Lesser indicates that by virtue of the waivers of various parties entitled to receive compensation as expenses of administration, together with additional waivers from members of the Creditors' Committee entitled to participate as unsecured creditors, the dollar requirements of the commitment could have been complied with both on July 15 and July 27, 1976, and, in fact, the Order of Confirmation of August 2, 1976, contains findings and statements sufficient to assure that no more than \$600,000 was required to confirm the Plan.

Judge Lesser and Judge Werker have correctly given no credence to Mangels' arguments that the \$150,000 limitation on priority and administration expenses included the pre-May 4, 1976 unpaid administration liabilities previously discussed herein. Such an argument, as previously

stated, is not consistent with either the facts or the understandings of the parties and must be deemed to have been waived by Mangels by virtue of its own actions. It is apparent from the record that Mangels seized upon this unreasonable argument on or about July 15, 1976, in order to frustrate confirmation. Mangels further argued on July 15, 1976, that the \$150,000 limitation on administration expenses was meant to include its own advances which, by its own admission, exceeded the sum of \$600,000, exclusive of the \$600,000 delivered under the commitment letter. To accept such argument would be to conclude that Mangels' commitment and the deposit delivered therewith was totally meaningless since Mangels would at all times have had it within its own control to establish a breach of such a condition.

Mangels' argument with regard to the commitment of pre-May 4, 1976 administration expenses and its allegation that payment of them, in fact, was in violation of the agreement and not within the contemplation of the parties, is unsupported and, in fact, is contradicted by the record. The record indicates that at the time that the Loan and Security Agreement and the other documents affecting the transaction were executed, Mangels sought little or no information from Fabric Tree regarding the nature and extent of outstanding

and unpaid administration expenses. (A. pp. 198-205) In fact, the president of Mangels indicated that he was somewhat uncertain as to the items which were to be included within the \$150,000 limitation. (A. pp. 192-200) Such uncertainty is understandable in light of the fact that he admittedly did not participate in the negotiations which gave rise to the agreements and therefore was not familiar with the understandings between the parties. (A. p. 175)

The record below clearly indicates that there was no business significance to the July 15, 1976 deadline and that, in fact, were there any significance to that date Mangels itself by its own actions made confirmation on July 15, 1976 impossible. The Court of Appeals for the 6th Circuit in the matter of Gulf Oil Corp. v. American Louisiana Pipe Line Co., 282 F.2d 401, held that a party to a contract had an affirmative obligation not to interfere with the processes of effectuating that agreement and having breached that duty that party could not rely upon the delay it had occasioned as a basis for cancellation of the agreement. Judge Werker cited that case with approval in the matter on review in this Court and it is respectfully submitted that the holding in that case is directly applicable to the facts and circumstances surrounding the instant controversy.

All of the foregoing indicates that the findings of

Judge Lesser, as affirmed by Judge Werker, were not clearly erroneous within the purview of Rule 810 of the Rules of Bankruptcy Procedure and as the courts of this Circuit have stated in Hedger v. Reynolds, 216 F.2d 202 (2d Cir. 1954):

"The burden on an appellant, who seeks to reverse a judgment for error in fact, to show that essential findings are clearly erroneous is, indeed, a heavy one, when, as in this instance, the decision must turn largely upon the credibility of witnesses the trial judge saw and heard."

Rule 810 was derived from Rule 52(a) of the Federal Rules of Civil Procedure and General Order 47. See Advisory Committee's Note to Rule 810. Decisions under Rule 52(a) are therefore helpful in construing the effect of Rule 810. As noted in the case of John Blue Company v. Dempster Mill Mfg. Co., 275 F.2d 668, 669 (8th Cir. 1960):

"A finding of fact by a district court is not 'clearly erroneous' so as to justify this court in setting it aside unless it is unsupported by substantial evidence, contrary to the clear weight of the evidence, or induced by an erroneous view of the law."

A review of the record demonstrates that Judge Lesser's findings as adopted by Judge Werker are based upon substantial evidence and, in fact, no other conclusions could have been reached by the Courts below upon the testimony adduced and evidence presented. Accordingly, this Court

would not be justified in disturbing the findings. Reich
v. Industrial Commissioner of New York, 145 F.2d 759, 761
(2d. Cir. 1944) [decision of Judge Augustus Hand].

Judge Lesser not only observed the demeanor of the witnesses who testified on July 27, 1976, but was intimately involved in the administration of this difficult case for many months prior to Mangels' appearance on the scene. As eloquently stated by him on July 30, 1976, there is perhaps a lesson to be learned by this extremely unusual situation "by people who serve as third party acquirers who want to feed at the trough of the Bankruptcy Court's door..."(A. p. 309)

POINT III

THE CONDUCT OF THE PROCEEDINGS IN THE BANK-
RUPTCY COURT AFFORDED APPELLANT OPTIMUM DUE
PROCESS AND WERE, IN FACT, CONSENTED TO BY
APPELLANT THROUGHOUT THEIR COURSE.

Mangels has sought to obfuscate the real issues in this proceeding, to wit, the jurisdiction of the Bankruptcy Court to determine the controversy, and the significance, if any, of the July 15, 1976 date included in the commitment, by raising belatedly a due process argument which should be given no credence by this Court. Mangels characterizes the proceedings before the Bankruptcy Court as being conducted in a manner designed

to detrimentally affect Mangels' rights and remedies. Such a contention is belied by the record.

As the record clearly indicates, Mangels willingly participated in the July 27, 1976 evidentiary hearing, reserving at that time only its objections to the summary jurisdiction of the Bankruptcy Court. (A. pp. 48, 49) On July 30, 1976, when Judge Lesser called the parties before him so as to read his decision into the record counsel for Mangels reiterated that they had agreed to participate in the July 27, 1976 hearing although objecting to the Court's jurisdiction. (A. pp. 315, 316)

The record of the July 27, 1976 hearing indicates that Mr. Rosenberg of the firm of Cole & Deitz, counsel to Mangels, stated that he was willing to accept the Court's decision that it had jurisdiction and to proceed with the evidentiary hearing reserving his objection to jurisdiction and thereby, in fact, consented to go forward. (A. p. 320) In fact, Mr. Rosenberg, during an earlier portion of the July 27, 1976 hearing and in the course of argument among counsel, stated that disputes with regard to the dollars involved could be resolved by Mr. Rosenberg's willingness to introduce testimony immediately with regard to the dollar requirements. (A. p. 315) Mr. Rosenberg's statements did, in fact, generate an immediate hearing

which proceeded on the afternoon of July 27, 1976.

On July 30, 1976, Judge Lesser's findings and conclusions based upon the July 27, 1976 evidentiary hearing were dictated into the record. It is interesting to note that it was only at the conclusion of the Judge's reading of his decision and with full knowledge of the import and effect thereof that counsel for Mangels raised its belated objections to the manner in which the proceedings of July 27, 1976 had been conducted and argued for the first time the alleged lack of due process afforded his client. The Court responded to this argument by correctly observing that Mangels was fully aware of what was transpiring at the hearings of July 13, July 15 and July 27, 1976, and was in no way surprised by what was going on. (A. p. 318)

The parties involved in this proceeding require identification when such an argument is raised. Mangels was represented by experienced corporate and insolvency counsel, all of whom had been intimately involved on a day to day basis in the transactions between Mangels

and Fabric Tree and had, in fact, been responsible for the drafting of the agreements which precipitated the controversy. Mr. Rosenberg himself is an acknowledged expert in insolvency matters and has appeared over the years with great regularity before Bankruptcy Courts and before Appellate Courts. The arguments of Mangels in its memorandum to this Court paint an incorrect picture of an unfortunate counsel and his client being thrust into a hearing for which they were not prepared and, if one is to accept Mangels' arguments, not immediately qualified to handle. Such an argument is without merit based upon the vast amount of legal experience which all counsel brought before the Court based upon their individual backgrounds in insolvency matters.

All of the parties present in Court on July 27, 1976, including the witnesses, were participants in all of the transactions which constituted the subject of the controversy and were as well or better prepared than any other counsel could have been to immediately try the issues and obtain the relief which each of them

sought for their respective clients.

As Judge Werker correctly noted in his decision, counsel for Mangels raised no due process objection at the July 27, 1976 hearing and agreed, in fact, to proceed with the hearing on the merits during the course of which he called several witnesses. Judge Werker correctly observes that Mangels knowingly waived its due process objection to the hearing below by failing to object, citing as authority for such waiver, the decisions of courts of this Circuit in United States v. Vitasafe Corp., 352 F.2d (2d Cir. 1965); Schwartz v. S.S. Nassau, 345 F.2d 465, 466 (2d Cir.), cert. denied, 382 U.S. 919 (1965).

The due process objection of Mangels having not been properly raised at the evidentiary hearing cannot be raised for the first time on appeal or form the basis for a reversal. See Desert Palace Inc. v. Salisbury, 401 F.2d 320, 324 (7th Cir. 1968) and Federal Savings and Loan Insurance Corp. v. Quinn, 419 F.2d 1014, 1019 (7th Cir. 1969).

CONCLUSION

The record below amply establishes that all of the conditions of the commitment which Mangels made to fund the debtor's Plan were complied with, save one, which,

as the record demonstrates, was not one which should have been strictly enforced. There is more than sufficient authority both in law and equity for the Bankruptcy Court's assumption of summary jurisdiction over these controversies.

The due process objections of Mangels with regard to the manner in which the proceedings were conducted are without merit based upon the unequivocal state of the record. Mangels has had the benefit of the bargain it made and while it may be displeased with the results of that bargain it cannot now be permitted to withdraw therefrom. Severe and substantial prejudice would result to Fabric Tree and its unsecured creditors were Mangels to obtain a return of the \$600,000 deposit after having also obtained, by foreclosure of its security interest, all of the assets of Fabric Tree and its subsidiaries. Such a result is not warranted either in law or equity and therefore the decision below should be affirmed in all respects.

Respectfully submitted,

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Of counsel,

MYRON TREPPER
MICHAEL J. CRAMES

UNITED STATES COURT OF APPEALS; 2nd CIRCUIT

Index No.

THE FABRIC TREE,
 Debtor,
 MANGEL STORES CORP., Appellant,
 - against -
 THE FABRIC TREE, INC.,
 Appellee,

Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF

ss.:

I, Victor Ortega, being duly sworn, depose and say that deponent is not a party to the action,
 is over 18 years of age and resides at 1715 Lacombe Avenue, Bronx, New York
 That on the 12th day of April 1977 at 40 Wall Street
 350 Fifth Avenue

deponent served the annexed

Brief

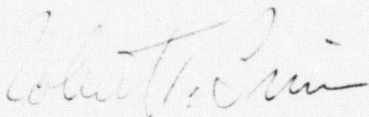
upon

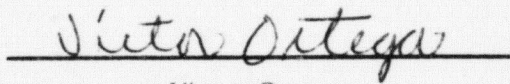
COLE & DIETZ

HAHN HESSEN MARGOLIS & RUAN

the in this action by delivering 2 true copies thereof to said individual
 personally. Deponent knew the person so served to be the person mentioned and described in said
 papers as the attorneys herein,

Sworn to before me, this 12th April
 day of 19 77




 Victor Ortega

ROBERT T. BRIN
 NOTAR, U. S. DIST. CT. New York
 N. Y. 10050
 Qualified in New York County
 Commission Expires March 30, 1977